Bridging the Government Pension Reporting Gap

The Effects of New GASB Standards on Government Pension Accounting

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For years, many observers have expressed concern about whether states will be able to meet their public employee retirement obligations. This debate has assumed greater urgency as state governments face increasingly serious fiscal challenges. As reported by the *Wall Street Journal*, almost every state (45 since 2009) has made cuts to public employee pensions ("Pension Crisis Looms Despite Cuts," Michael Corkery, Sept. 22–23, 2012, p. A1); however, these steps have failed to significantly reduce the gap between what state governments owe and the assets set aside in their retirement plans.

Accounting for government pensions is now set to undergo the most significant changes since GASB's formation in 1984. The provisions of GASB Statement 67, *Financial Reporting for Pension Plans* (effective June 15, 2013), and GASB Statement 68, *Accounting and Financial Reporting for Pensions Plans* (effective June 15, 2014), apply to reporting by pension plans and employers, respectively. (A

summary of the new standards appears in *Exhibit 1*.) Together, the new standards represent a significant improvement in determining whether governments are setting aside sufficient assets to cover pension commitments; however, the improved reporting will also greatly increase the pension expense and liabilities recognized by government entities, further revealing the degree to which underfunding exists. The new standards relate solely to accounting and financial reporting; they do not apply to a government's approach toward pension plan funding.

Background

The following discussion examines the current condition of government pension funding, the specific provisions of the new standards, and the anticipated effect on the reported pension obligation. GASB Statement 67 revises existing reporting standards for the financial reports of most defined benefit pension plans, whereas GASB Statement 68 establishes new accounting and financial reporting requirements for government pension plans. Existing standards for governments that provide defined contribution plans generally remain unchanged.

The new rules are the culmination of an effort initiated in 2006, when GASB began a research project to examine whether the current standards were effective in providing decision-useful information that both supported accountability and promoted transparency. The existing rules have been roundly criticized for severely understating the pension obligations on the balance sheets of public entities by disclosing the amount of unfunded pension liability in the notes to their financial statements, rather than recognizing a liability on the face of the balance sheet.

Under the new standards, governments with defined benefit plans are required to disclose a "net pension liability" on their balance sheet equal to the difference between the total pension liability and the amount of plan assets formally set aside for payment of benefits, as of the reporting date. The total pension liability represents the portion of the present value of projected benefit payments that is attributed to past periods of employee service. For example, an employer with a $5 million total pension liability and $4.5 million in plan assets would report $500,000 as a net pension liability.

Annual pension expense will reflect the annual service cost and interest on the pension liability, as well as the effect of changes in benefit terms on the net pension liability, instead of the required funding amounts. Under the new standards, pension costs and obligations should be accrued as employees earn them, rather than based on required funding amounts. Current standards measure the pension liability on a government's balance sheet as the difference between the required contributions to a pension plan in a given year and what was actually funded.

The updated guidance marks a dramatic turn in the accounting for public pensions. Furthermore, GASB is implementing changes in the calculation of the obligation that will increase the liability; the primary changes are also associated with significantly increased note disclosures and required supplementary information.

The new statements will result in three significant changes to pension accounting and reporting by state and local governments. First, the asset value required for accounting purposes will be the fair (market) value of assets, rather than the smoothed number previously allowed for funding purposes. Second, the discount rate used to value the liability will be based on a blended rate that reflects the long-term expected return on plan investments and the yield on tax-exempt municipal bonds. Third, the entry age normal/level percentage of payroll will be the sole allocation method used for accounting and financial reporting purposes. Fundamentally, the new standards break the close link between pension accounting and required funding amounts that has existed, and they will greatly impact the valuation of assets and liabilities.

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Public Pension Controversy

A revised analysis by the Pew Center on the States, a national public policy think tank, illustrates how states are struggling to keep up with their pension commitments (June 2012, http://www.pewstates.org/state-pensions-update). This study is based upon data from fiscal year 2010, the latest budget year for which complete numbers were available from all 50 states (see *Exhibit 2*). Although most states have taken some steps to reduce this problem by some combination of higher contributions from taxpayers or employees and benefit cuts, much remains to be done. The study found that only Wisconsin was fully funded in 2010, a stark contrast to 2000, when more than half of the states were 100% funded. A benchmark for a healthy pension system is generally viewed as at least 80% funded, yet 34 states remained below that standard in 2010, up from 22 states in 2008. Four states—Connecticut, Illinois, Kentucky, and Rhode Island—were less than 55% funded in 2010.

A significant recession followed by stagnant economic growth and historically low interest rates have combined to create a difficult challenge for states in meeting their long-term pension costs. The Pew Center on the States found the gap between states' assets and their obligations for public sector retirement benefits to be $1.38 trillion in 2010, up nearly 9% from fiscal year 2009; this total consists of $757 billion

for pension benefits and $627 billion for retiree healthcare.

The Center for Retirement Research at Boston College maintains a database of 126 state and local plans (Alicia H. Munnell, Jean-Pierre Aubry, Josh Hurwitz, and Laura Quinby, "How Would GASB Proposals Affect State and Local Pension Reporting?" Center for Retirement Research at Boston College, updated July 2012, http://crr.bc.edu/briefs/how-would-gasb-proposals-affect-state-and-local-pension-reporting/). This database represents approximately 90% of the assets in state-administered plans and 30% of those in plans administered at the local level. The funded ratio (plan assets divided by employer liabilities) for the plans in its database was 76% in 2010 and an estimated 75% in 2011. The blended discount rate used by the new standards will increase costs. The Center for Retirement Research now estimates that the funded ratio under GASB's new procedures in 2010 would have been just 57% instead of 76%. This change means that the pension liabilities of the 126 state and municipal pension plans would have increased by roughly $600 billion if the new standards had been implemented in 2010.

State Budget Solutions (SBS), a nonprofit organization advocating fundamental reform of state finances, adopts a darker view of governments' effectiveness in funding pensions and takes issue with the interest rate used to discount the guaranteed pension liabilities (Andrew G. Biggs, "Public Sector Pensions: How Well Funded Are They, Really?," SBS, July 2012). Under current GASB rules, a public pension plan discounts its liabilities at the rate of return expected to be earned by the portfolio of assets that it holds. Governments use a discount rate that ranges from 6% to 8.5%, with the average being close to 8%. According to the researchers at Boston College, the average state and local pension plan in 2011 was about 75% funded based upon an 8% discount rate. Under the most likely conditions, the same researchers are projecting the ratio of assets to liabilities to rise to 82% in 2015.

But most economists are of the opinion that GASB accounting rules significantly underestimate the value of public pension liabilities (Biggs, p. 1). It is a tenet of financial economics that the interest rate used to discount the guaranteed liability should be based upon the risk of the liability, rather than the expected rate of return on assets in the plan (Franco Modigliani and Merton H. Miller, "The Cost of Capital, Corporation Finance, and the Theory of Investment," *American Economic Review*, June 1958, pp. 261–297). Accordingly, if public pension benefits are guaranteed—as is typical—then the interest rate selected should be one based upon guaranteed investments, such as U.S. Treasury securities. A lower interest rate means that it is more expensive to fund any given level of future guaranteed payments; thus, the costs of the plan increase.

Some might argue that the new rules do not provide a discipline for maintaining systematic allocations according to a long-term investment schedule when investments are performing well. When investments outperform expectations, pension managers might be tempted to reduce periodic contributions below the level specified under a long-term investment schedule—that is, the use of current Treasury yields in determining future payment schedules might tempt pension liability holders to reduce payments when investment returns revert to historical (higher) levels. But this scenario requires that the pension liabilities be evaluated as "overfunded" at some time in the future before a reduction in payments would occur; therefore, this scenario represents a lower risk to pension viability than the possibility of underfunding due to valuations based upon overly optimistic returns. In any case, the use of Treasury yields creates a more conservative approach to pension funding and liability valuation than current practice. Using the Treasury bond rate of 3.64% in 2011 and applying that rate to the database compiled by Boston College, the SBS study computed a funded ratio of 41.2% for 2011, rather than of 75%, and total unfunded liabilities of about $4.6 trillion, rather than $885 billion.

Economists Robert Novy-Marx and Joshua Rauh calculated the increase in contributions required over 30 years to achieve the full funding of state and local pension systems in the United States ("The Revenue Demands of Public Employee Pension Promises," 2012, http://www.statebudgetsolutions.org/publications/detail/the-revenue-demands-of-public-employee-pension-promises). Without policy changes, contributions must rise from 5.7% of government revenues (the current level) to

EXHIBIT 1
Summary of GASB Pension Guidance

New Standard*	Amended Standard	Effective Date
GASB Statement 67 *Financial Reporting for Pension Plans–an amendment of GASB Statement No. 25*	Statement 25 *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures*	Plan fiscal years beginning after Jun. 15, 2013 (earlier application encouraged)
GASB Statement 68 *Accounting and Financial Reporting for Pension–an amendment of GASB Statement No. 27*	Statement 27 *Accounting for Pensions by State and Local Government Employers*	Employers' fiscal years beginning after Jun. 15, 2014 (earlier application encouraged)

* Full text available at http://www.gasb.org/jsp/GASB/Page/GASBSectionPage&cid=1176160042391

14.1% of revenues; average contributions would need to rise to 40.4% of payroll. Novy-Marx and Rauh computed the average immediate tax increase to be $1,385 per household per year. The discount rate used was the real risk-free rate of return, approximated by the yield on long-duration Treasury inflation-protected securities (TIPS; 1.7% as of December 2010) plus inflation. The authors found that, in 2009, no state—with the possible exception of Indiana—contributed the full present value of new benefit promises when such promises are measured using government bond yields as the discount rate.

GASB Statement 67

GASB Statement 67 aims to address financial reporting by state and local governmental pension plans; it applies specifically to accounting and financial reporting for the activities of pension plans that are administered through trusts that have the following characteristics:

- Contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are irrevocable.
- Pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms.
- Pension plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the pension plan administrator.

For defined benefit pension plans, a distinction is made in terms of financial reporting requirements, depending upon the type of pension plan administered. (The sidebar, *Classification of Pension Plans*, describes the four types.) Although these classifications are not new, the financial reporting requirements for each will change significantly. Existing standards require information about the unfunded liability to be discussed in the notes to the employer's financial statements; however, GASB Statement 67 requires the obligation associated with the pension benefits promised to employees through a qualified trust to be recognized in the financial statements, regardless of the type of benefit plan arrangement used.

Notes to the financial statements. GASB Statement 67 requires that notes to the financial statements of defined benefit pension plans include descriptive information, such as the types of benefits provided, the classes of plan members covered, and the composition of the pension plan's board. Such pension plans should also disclose information about pension plan investments, including investment policies, a description of how fair value is determined, concentrated investments with individual organizations equaling or exceeding 5% of the pension plan's fiduciary net position, and the annual money-weighted rate of return on pension plan investments.

Disclosures affecting single- and agent-employer plans. Governments with single-employer and cost-sharing pension plans should disclose the total pension liability, the pension plan's fiduciary net position, the net pension liability, and the pension plan's fiduciary net position as a percentage of the total pension liability. The net pension liability represents the employer's total pension liability, less the amount of plan assets (the net position of the plan) formally set aside for payment of benefits, as of the reporting date. The total pension liability represents the portion of the present value of projected benefit payments that is attributed to employees' past periods of service. Governments are now required to report the net pension liability in their accrual-based financial statements (e.g., the government-wide statement of net position).

Single and agent governments will also be required to disclose for the current period the beginning and ending balances of the net pension liability and the effects of changes during the period (e.g., effects of service cost, benefit changes, actual investment earnings). Further information should include significant assumptions and other inputs used to calculate the total pension liability, including those about inflation, salary changes, ad hoc postemployment benefit changes (including ad hoc cost-of-living adjustments [COLA]), inputs to the discount rate, and certain information about mortality assumptions and the dates of experience studies.

Single and agent governments must present in required supplementary information the following amounts for each of the past 10 years:

- The beginning and ending balances of the total pension liability, the plan trust's net position, the net pension liability, and their components
- Total pension liability, the plan's net position, the net pension liability, a ratio of the plan's net position to the total pension liability, the covered-employee payroll, and a ratio of the net pension liability as a percentage of the covered-employee payroll.

If the contributions of employers or nonemployer contributing entities to a single-employer or cost-sharing pension plan are actuarially determined, the pension plan should present in required supplementary information a schedule covering each of the 10 most recent fiscal years that includes the following information: 1) the actuarially determined annual pension contribution; 2) the amount of employer contributions actually made; 3) the difference between items 1 and 2; 4) the payroll of employees covered by the plan; and 5) a ratio of item 2 divided by item 4. Any significant methods and assumptions used in calculating the actuarially determined contributions should be presented as notes to the schedules.

Some might argue that the new rules do not provide a discipline for maintaining systematic allocations according to a long-term investment schedule when investments are performing well.

EXHIBIT 2
The Widening Gap in Public-Sector Pensions

State	Liability (in thousands)	Percentage Funded	Required Contribution (in thousands)	Percentage Paid
Alabama	$42,942,101	70%	$1,165,133	100%
Alaska	16,592,762	60	397,137	83
Arizona	46,500,674	75	1,108,252	101
Arkansas	23,822,512	75	567,869	106
California	516,306,424	78	13,320,725	75
Colorado	59,338,149	66	1,346,763	66
Connecticut	44,826,900	53	1,472,000	87
Delaware	7,922,174	92	148,586	97
Florida	148,116,907	82	2,856,920	107
Georgia	81,093,057	85	1,330,043	100
Hawaii	18,483,700	61	536,237	102
Idaho	12,589,300	79	265,835	113
Illinois	138,794,302	45	4,761,507	87
Indiana	39,005,478	65	1,476,131	94
Iowa	27,057,850	81	524,877	89
Kansas	21,853,783	62	682,062	72
Kentucky	37,006,999	54	1,023,900	58
Louisiana	41,356,966	56	1,599,612	84
Maine	14,799,200	70	330,300	103
Maryland	54,498,265	64	1,544,873	87
Massachusetts	63,937,435	71	1,869,172	65
Michigan	77,848,000	72	1,646,859	86
Minnesota	57,604,243	80	1,325,843	65
Mississippi	32,201,243	64	762,327	100
Missouri	57,205,874	77	1,283,551	89
Montana	11,029,954	70	243,754	81
Nebraska	9,969,089	84	202,150	100
Nevada	35,163,755	70	1,394,802	92
New Hampshire	9,013,758	59	271,582	100
New Jersey	123,234,638	71	4,506,227	32
New Mexico	30,184,912	72	692,779	88
New York	156,572,000	94	2,344,222	100
North Carolina	79,558,260	96	771,800	100
North Dakota	4,977,500	72	107,524	66
Ohio	175,368,439	67	3,770,640	67
Oklahoma	36,368,239	56	1,514,350	70
Oregon	59,329,500	87	472,400	100
Pennsylvania	118,165,428	75	2,795,100	29
Rhode Island	13,382,099	49	306,428	100
South Carolina	43,963,133	66	956,643	100
South Dakota	7,502,301	96	98,876	98
Tennessee	35,198,741	90	836,727	100
Texas	163,417,834	83	3,363,531	82
Utah	25,711,658	82	695,221	100
Vermont	4,090,537	75	89,514	94
Virginia	75,889,000	72	1,594,447	67
Washington	61,747,228	95	1,880,100	53
West Virginia	14,986,050	58	602,221	93
Wisconsin	80,758,800	100	686,700	108
Wyoming	7,740,611	86	152,973	82

Source: *Pew Center on the States*, 2012 State Pensions Update

Measurement of the net pension liability. The net pension liability is to be measured as the total pension liability less the amount of the pension plan's fiduciary net position. Actuarial valuations of the total pension liability must be performed at least every two years, with more frequent valuation encouraged. The measurement of the total pension liability entails three essential steps:

- Projecting future benefit payments for current and former employees
- Discounting those payments to their present value
- Allocating the present value over past, present, and future periods of employee service.

Projections of benefit payments are based upon the benefit terms and legal agreements existing at the pension plan's fiscal year-end and must incorporate the effects of projected salary changes and service credits, as well as projected automatic postemployment benefit changes (including automatic COLAs). Alternatively, ad hoc COLAs and other ad hoc benefit changes made at the discretion of the government, will only be included in projections if they occur with such regularity that they are, in effect, automatic.

Discount rate. Current standards require governments to apply a discount rate equal to the long-term expected rate of return on the investments of the pension plan (typically, 6% to 8%). Under one of the key provisions of GASB Statement 67, however, a single, blended discount rate will be computed in two steps:

- The long-term expected rate of return is applied to the extent that a pension plan's net position and projected contributions are expected to fully cover projected benefit payments to the employees.
- Any excess projected benefit payments will be discounted using a tax-exempt, high-quality 30-year municipal bond index rate.

Under GASB Statement 67, governments will project the benefit payments for each year and the amount of plan assets available to pay benefits to current employees, retirees, and their beneficiaries. As long as plan assets are projected to be sufficient to make the projected benefit payments, governments would discount projected benefit payments using the long-term expected rate of return. Governments must use the blended inter-

est rate only when future benefit payments are not expected to be made from current and expected future plan assets. Currently, most high-quality tax-exempt municipal bonds carry an interest rate that is substantially lower than that of plans' long-term investment return assumptions. The result of using a lower discount rate would be a larger present value and, therefore, a larger net pension liability in the financial statements.

This provision is one of the most controversial areas of GASB Statement 67. Because many governments are not investing sufficient assets to meet their projected payments, they will be required to discount the excess projected payments using the tax-exempt or high-quality municipal bond index rate. The blended discount rate will be lower than the rate used by governments at present, and thus will result in a larger expected liability. For example, the aforementioned researchers at Boston College estimated that its 2011 sample of 126 plans had an aggregate liability of $3.6 trillion using a typical discount rate of 8% (although some sponsors have begun to lower the discount rate used). If a discount rate of 5% were used for the same sample, the aggregate liability would increase from $3.6 trillion to $5.4 trillion.

After projected benefit payments have been discounted to their present value, they are allocated over a period related to the service period of the employees covered under the plan. Under the current standard, governments can choose from six methods for assigning the present value of benefit payments to specific years for accounting and financial reporting purposes. Under GASB Statement 67, however, all entities will be required to use the entry-age normal method applied as a level percentage of payroll. The use of a single required method should significantly improve the comparability of pension information disclosed by governments.

Defined contribution plans. Defined contribution plans stipulate the amount to be contributed to an employee's account each year, not the amount of benefits an employee will receive after employment ends. The new standards will essentially continue to follow the existing requirements. Governments will report an expense equal to the amount that they are required to contribute for employee service each year, and a liability equal to the difference between that required contribution and what the government actually contributes.

GASB Statement 68

GASB Statement 67 amends GASB Statement 25, *Financial Reporting for Defined Benefit Plans and Note Disclosures for Defined Contribution Plans*, and applies to state and local pension plans established as trusts or similar arrangements. GASB Statement 68 amends GASB Statement 27, *Accounting for Pensions by State and Local Governmental Employers,* and applies to governments that sponsor or contribute to state or local pension plans. Together, both statements establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement: determining pensions, accumulating and managing assets dedicated for pensions, and paying benefits to plan members as they come due. The two statements are closely related in some areas, and certain provisions of GASB Statement 68 refer to GASB Statement 67.

GASB Statement 68 establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expenses/expenditures. For defined benefit pensions, it identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

Types of defined benefit pension plans and employers. Statement 68 expands the note disclosure and required supplementary information requirements for pensions. These requirements differ depending upon how employers are classified. For purposes of this statement, employers are classified in one of the four categories described in the sidebar.

Single and agent employers. For governments with single or agent employer

Assistant/Associate/Full Professor or Lecturer • Accounting
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plans, the net pension liability represents the employer's total pension liability less the amount of plan assets formally set aside for payment of benefits as of the reporting date. The total pension liability is the portion of the present value of projected benefit payments that is attributed to past periods of employee service. The pension expense and deferred outflows/inflows of resources related to pensions that are required to be recognized by an employer result primarily from changes in the components of the net pension liability. GASB Statement 68 requires the inclusion in pension expense of most changes in the net pension liability.

Pension expense. The amount a government reports as pension expense in the financial statements is the product of a variety of factors:

- Whether employees work more and earn more benefits
- The interest on the total pension liability
- Changes in benefit terms
- The effect on the total pension liability of differences between assumed and actual economic and demographic factors (and changing assumptions about those factors)
- Projected earnings on plan investments
- Changes in plan net position from items other than investments (e.g., employer and employee contributions, plan administrative expenses).

Currently, only the first, second, and sixth items above are generally incorporated into the calculation of pension expense immediately. The third, fourth, and fifth items above have been recognized as expense over a period of up to 30 years, but the new standards will accelerate the recognition of these items. For example, the effect of benefit changes will be recognized in the period of the change. The effect on the total pension liability of changes in assumptions and differences between assumptions and actual experience are to be recognized initially as deferred outflows/inflows of resources and then systematically incorporated into pension expense over the average remaining service period of those employees. This period is expected to be significantly shorter than the period over which governments may now recognize the allocation of their pension expense. Finally, the difference between the expected earnings on plan investments and actual investment earnings will be deferred and included in expense in a systematic and rational manner over a five-year closed period, rather than over the longer periods allowed under current standards.

Reporting in Cost-Sharing Multiple-Employer Plans

The majority of state and local governments participate in cost-sharing plans. Cost-Sharing employers have previously not been required to present actuarial information about pensions; instead, they have been required to present information in the pension plan's own financial statements for all the participating governments combined. GASB has concluded that the needs of users regarding cost-sharing employers do not differ significantly from single and agent employers; therefore, the new standards require that cost-sharing governments report a net pension liability, pension expense, and deferred outflow of resources based upon their proportionate share of the collective amounts for all the governments in the plan.

Note disclosures and required supplementary information. Under Statement 68, governments will continue to disclose information about their pension obligations in both the notes to the financial statements and required supplementary information following the notes. The requirements for note disclosures and required supplementary information differ based upon whether the benefit arrangement is single, agent, or cost sharing. All types of benefit arrangements are required to include the following information in note disclosures:

- Descriptions of the plan and benefits provided
- Significant assumptions employed in the measurement of the net pension liability
- Descriptions of benefit changes and changes in assumptions
- Assumptions related to the discount rate and the impact on the total pension liability of a one percentage point increase or decrease in the discount rate
- Net pension liability, deferred outflows of resources, and deferred inflows of resources.

Single and agent governments also will have to disclose the following for the current period:

- Beginning and ending balances of the total pension liability, plan net position, net pension liability, and the effects on the balances during the current period
- Amount of pension expense recognized during the current period (including separate identification of the components of pension expense)
- Separate reconciliations of beginning and ending balances of deferred outflows/inflows of resources related to pensions, with separate identification of each change.

Required supplementary information. Governments with single and agent plans

CLASSIFICATION OF PENSION PLANS

- *Single-employer pension plans*—pensions are provided to the employees of only one employer.
- *Multiple-employer pension plans*—pension benefits are provided to the employees of more than one employer.
- *Agent multiple-employer pension plans (agent pension plans)*—plan assets are pooled for investment purposes but separate accounts are maintained for each individual employer, so that each employer's share of the pooled assets is legally available to pay the benefits of only its employees.
- *Cost-sharing multiple-employer pension plans (cost-sharing pension plans)*—the pension obligations to the employees of more than one employer are pooled and plan assets can be used to pay the benefits of the employees of any employer that provides pensions through the pension plan.

must present required supplementary information schedules covering the past 10 years, with information on the following:

- The beginning and ending balances of the total pension liability, the plan trust's net position, the net pension liability, and their components
- The total pension liability, the plan's net position, the net pension liability, the ratio of the plan's net position to the total pension liability, the covered-employee payroll, and the net pension liability as a percentage of the covered-employee payroll
- Notes to these required schedules.

If a single, agent, or cost-sharing government plan has an actuarially determined annual pension contribution (or, if not actuarially determined, then the statutorily determined contribution), it is also required to present a required supplementary information schedule covering the past 10 years, with the following information:

- The actuarially determined annual pension contribution (or, if not actuarially determined, then the statutorily determined contribution)
- The amount of employer contribution actually made
- The difference between the two points above
- The payroll of employees covered by the plan
- A ratio of actual employer contributions compared to covered payroll.

Governments with a cost-sharing multiple-employer plan will present the same required supplementary information schedules as required above, but the schedules will cover the plan as a whole. Disclosure will also be required for the total pension liability, the plan's net position, the net pension liability, the ratio of the plan's net position to total pension liability, the covered-employee payroll, and the ratio of net pension liability to covered-employee payroll for its proportionate share of the aggregate amounts.

Special Funding Situations

Special funding situations are circumstances in which an entity other than the employer government (usually another government) is legally responsible for contributing to the plan, and one or both of the following conditions are met:

- The nonemployer is the only entity with a legal obligation to make contributions directly to the plan.
- The amount of the contributions for which the nonemployer is legally responsible is not dependent upon one or more events unrelated to the pensions.

The controversy surrounding pension commitments is one of the most pressing issues faced by state and local governments.

In a special funding situation, the nonemployer has essentially assumed a portion of the employer entity's pension obligation as its own. Consequently, if the nonemployer is a government, its financial statements will reflect its proportionate share of the employer's net pension liability, deferred outflows and inflows of resources, and pension expense.

The government employer benefiting from the nonemployer's contributions in a special funding situation will calculate its net pension liability, pension expense, and deferred outflows and inflows of resources related to pensions prior to the nonemployer government's support; however, its financial statements will only reflect its proportionate share of the net pension liability and deferred outflows and inflows of resources. The employer will recognize its pension expense in full, but it will recognize revenue for the portion that will be contributed by the nonemployer.

GASB Statement 68 requires an employer to disclose in the notes to financial statements any information about the amount of support provided by nonemployer contributing entities, and to present similar information about the involvement of those entities in 10-year schedules of required supplementary information. If a nonemployer is responsible for a "substantial" portion of one or more employers' pension liabilities, it should disclose in the notes to the financial statements a description of the pensions, including the types of benefits provided, the employees covered, and the discount rate and assumptions made in the measurement of the net pension liability. The governmental nonemployer contributing entity also should present schedules of required supplementary information similar to those required of a cost-sharing employer.

Looking to the Future

The controversy surrounding pension commitments is one of the most pressing issues faced by state and local governments. Based upon the current interest rate and cost assumptions included in GASB Statement 67, public pensions are underfunded by hundreds of billions of dollars. According to some economists, the true state of public pension funding is far worse. Since 2010, many state and local governments in the United States have instituted reforms to public-sector pension plans that include increased contributions, less generous benefits for newly hired employees, and reductions in COLAs for current beneficiaries.

GASB has responded by making sweeping changes in pension accounting and by attempting to improve future benefit, liability, and funding recognition. Statements 67 and 68 call for a net pension liability to be reflected on governmental fund balance sheets so that users can determine the amount a government is obligated to pay for pension benefits in excess of what has been set aside in pension plan trusts. The new standards also will apply to governments participating in multiemployer cost-sharing plans. Those employers will be required to report a liability equal to their proportionate share of the collective net liability of the plan. The new requirements represent an improvement over previous standards in helping taxpayers and other users determine whether governments are currently setting aside enough assets to fulfill their future pension commitments. ❑

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